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MERCANTILE STORES COMPANY, INC.

AND SUBSIDIARIES

Annual Report

FOR THE YEAR ENDED JANUARY 31, 1967

MERCANTILE STORES COMPANY, INC.

BOARD OF DIRECTORS

JOHN E. BIERWIRTH
F. K. BRADLEY
MORGAN A. CASEY
ASHTON HAWKINS
HAROLD W. JOCKERS
F. G. KINGSLEY
GERRISH H. MILLIKEN, JR.
MINOT K. MILLIKEN
ROGER MILLIKEN
GEORGE S. MOORE
R. NELSON SHAW
RALPH S. STILLMAN

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R. NELSON SHAW, *President*
F. G. KINGSLEY, *Chairman of the Executive Committee*
F. K. BRADLEY, *Vice-Chairman of the Board*
MORGAN A. CASEY, *Vice-President*
CHARLES E. STALLINGS, *Vice-President*
FREDERICK W. BLECKWENN, *Vice-President*
EDWARD J. SHARKEY, *Vice-President*
R. S. KIZER, *Controller*
WILLIAM A. HEINEMAN, *Treasurer*
ASHTON HAWKINS, *Secretary*

Stock Transfer Agent
CHEMICAL BANK NEW YORK TRUST COMPANY
20 Pine Street
New York

Registrar of Stock
FIRST NATIONAL CITY BANK
399 Park Avenue
New York

FINANCIAL HIGHLIGHTS

IN BRIEF

	1966 (Year ended Jan. 31, 1967)	*1965* (Year ended Jan. 31, 1966)
Sales	$234,267,366	$220,610,170
Sales Increase Percentage	6.2%	6.4%
Profit Before Income Taxes	17,394,175	16,590,344
Percent to Sales	7.4%	7.5%
Net Profit	9,074,175	8,600,344
Profit Per Share	$3.08	$2.92
Dividends Paid:		
Per Share	$1.40	$1.20
Percentage of Profit Paid Out	45%	41%
Cash Flow:		
Amount in Dollars	12,684,000	11,956,000
Amount Per Share	$4.30	$4.06
Book Value Per Share	$24.84	$22.82
Working Capital	44,768,499	42,075,189
Ratio of Net Profit to Invested Capital	12.4%	12.8%

MERCANTILE STORES COMPANY, INC.

AND SUBSIDIARIES

100 West 10th Street
Wilmington, Delaware
April 14, 1967

Fellow Stockholders:

This report covers the year ended January 31, 1967, our forty-eighth year. New records in sales and profits were again achieved by the Company.

Sales aggregated $234,267,366. Net profit was $9,074,175. Earnings per share amounted to $3.08.

Profit

Our profit for the year was the highest in the history of the Company. The pre-tax profit of $17,394,175 was $803,831 higher than last year's profit of $16,590,344 (the previous record high). The net profit of $9,074,175 was better than last year by $473,831.

We had very good business during the first nine months of the year. Near the end of September the sales increases began to taper off. Sales for the first nine months were ahead by about 8%, but for the final quarter the sales increase was approximately 3%. Profit results for the final three months (which include year-end adjustments) came out about the same as the preceding year.

Sales for the year were up about 6% and profit up about 5½% with the result that the pre-tax profit percent to sales dropped down one tenth of a percent. The current year's figure was 7.4% compared with 7.5% for last year.

There was no major distortion in the profit comparison of the two years—because of unusual or non-recurring factors. Profit was helped by about 5 cents per share in connection with a warehouse we own in Kansas City. The state authorities appropriated part of our property for road building and the condemnation award was well above the value at which the property was carried on our books. Profit was also helped by about 1 cent per share because of a little larger investment credit in the latest year.

In the other direction, profit was hurt by about 2½ cents because of the increase in prime interest rates, and hurt by about 1 cent because of Canadian exchange.

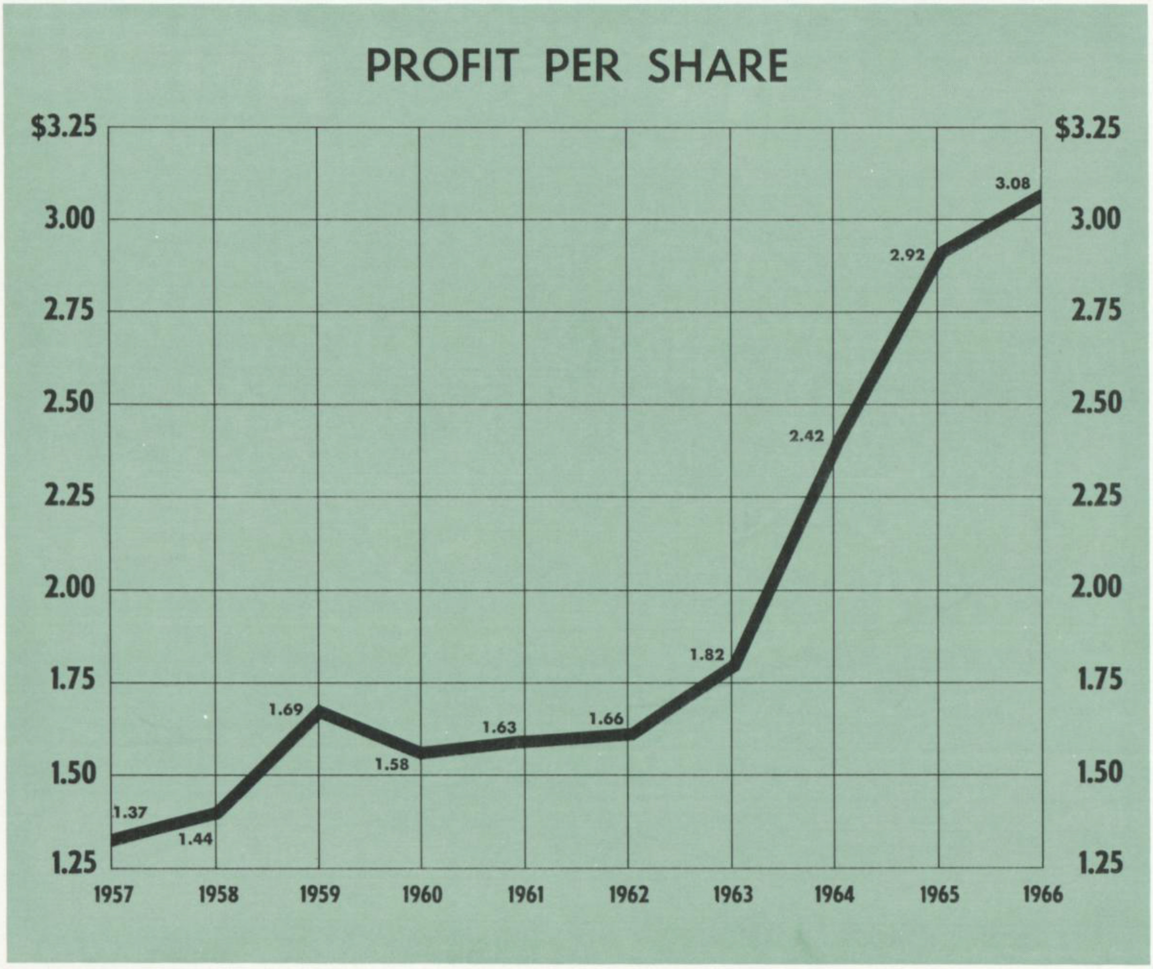
The sales increase of $13,657,196 was the most important factor in the profit increase. Mark-downs were higher but this was more than offset by an improvement in mark-up. (To briefly explain these retail trade terms—mark-downs refer to reductions in price—for one reason or another—from the price put on the goods when they were first offered for sale; mark-up refers to the profit margin. If we buy an item for $6.25 and price it to sell for $10.00, the mark-up is $3.75.)

The expense percentage to sales was a small fraction higher than last year (the increase was less than one tenth of one percent).

The profit per share exceeded $3.00 for the first time since the stock was split 2 for 1 in 1962. The per share earnings for the last four years have been:

Year Ended	
January 31, 1964	$1.82
January 31, 1965	2.42
January 31, 1966	2.92
January 31, 1967	3.08

The chart below gives the profit per share for the last ten years. As shown on the chart, the profit per share of $3.08 is more than double the per share profit of ten years ago.



Sales

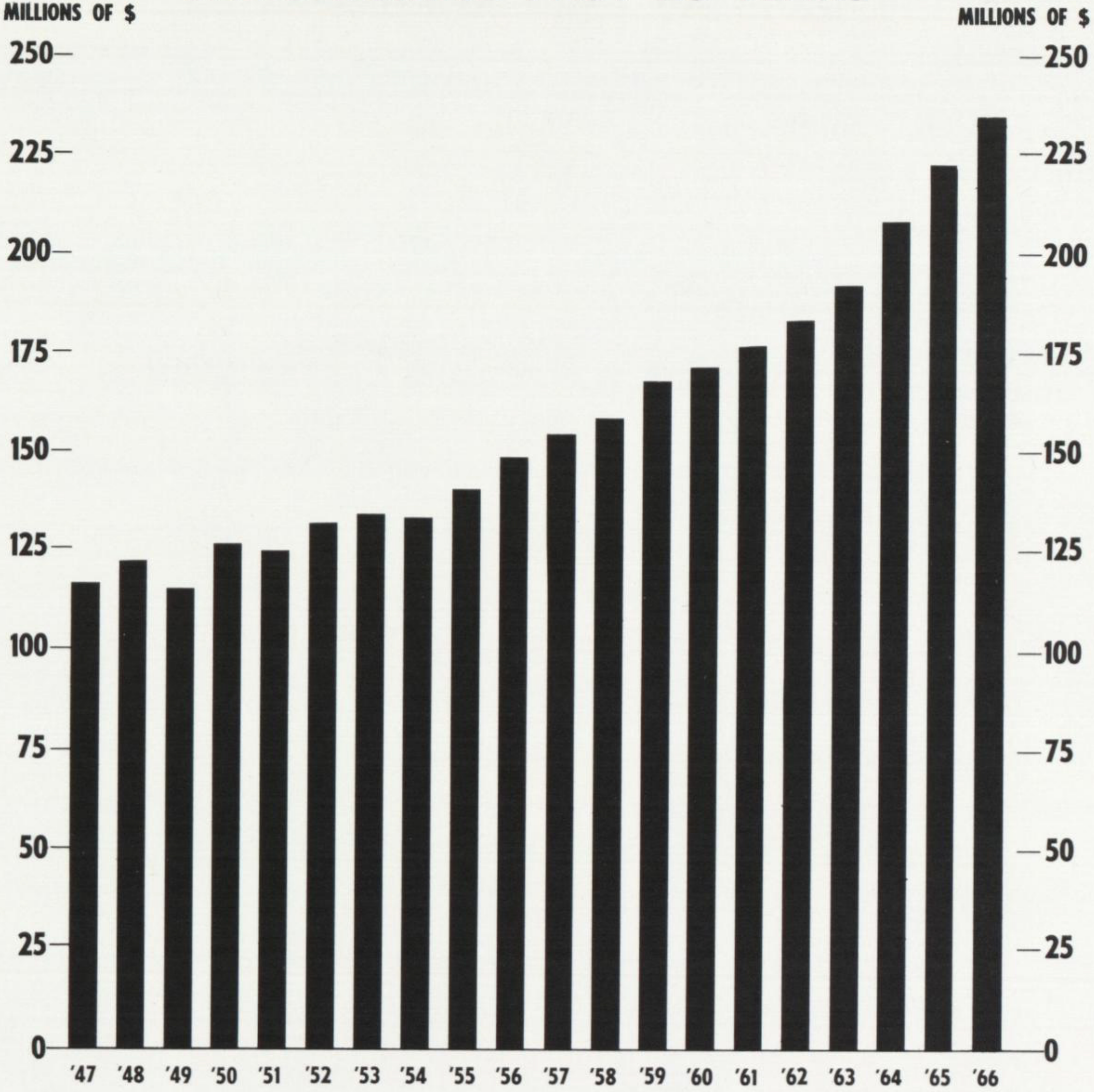
Sales for the year aggregated $234,267,366. This is the twelfth consecutive year in which a new sales record has been set. The sales increase of 6.2% amounted to $13,657,196. Sales in comparable stores which were open for the full twelve months in both years, showed an increase of 5%.

The proportion of our business done in suburban stores (as compared with downtown stores) continued to accelerate in the year under review. In this latest year 57% of total Company sales came from these newer stores, with 43% from the older downtown stores. In the previous year, the percentages were 53% and 47%, respectively. The rise in the suburban proportion in the one year was a little sharper than in recent years. One contributing factor was that our major store in downtown Seattle operated during the earlier year—but not during the later year (it was closed January 31, 1966).

We expect this 57% will be a larger figure for the coming year as more suburban stores will be opened (details are given later on in this report under "Expansion"). This steady increase in suburban store sales constitutes an important change in the character of our business which has developed in comparatively recent years. In 1950 the percentage of business done in suburban stores was only 15%. In general these new suburban stores can be operated at a lower expense ratio than the older downtown stores. Various factors enter into this. One is advertising can frequently be handled with very little additional cost—by simply listing the new suburban store in the newspaper advertisements for the downtown mother store. Secondly, delivery expense is lower in the suburban stores. The housewife usually drives her car and parks near the store. It is convenient for her to take her purchases with her—even bulky items. If she bought the same items in a downtown store, she much more frequently asks that the merchandise be delivered. This costs the store money. Although there are occasional exceptions, on the average the suburban stores are more profitable than the older downtown stores.

The chart opposite shows the total sales of the Company for the last twenty years. During the last twenty-seven years there have been only three years in which sales did not go ahead. The last time we had a sales decrease was 1954.

SALES DURING PAST 20 YEARS



Inventory

Merchandise inventories currently show a good relationship to sales. Sales increased 6.2% for the year, and at January 31, 1967 inventories were up over a year ago by only 3.6%. When sales slow up (as they did to some degree last fall) it generally requires higher markdowns to bring the inventory into line, and 1966 followed this pattern. However, by January 31st this inventory adjustment had been completed. The inventory total at January 31st was $33,324,842 against $32,178,978 for the year before—an increase of $1,145,864, or 3.6%, as noted above.

Square Feet of Store Properties

At January 31, 1966 there were approximately 4,427,000 square feet of space in our store buildings. During the year under review 337,000 square feet of new space was added, and one 30,000 square foot store was closed. The net addition of space for the year was 307,000 square feet, with the result that we ended the year at January 31, 1967 with total square feet of 4,734,000.

The new space added during the latest year consisted of 197,000 square feet in three new stores opened during the year, 97,000 square feet in two stores enlarged during the year, and 43,000 square feet of increased space resulting from relocating two stores.

The figures of square footage given above, represent total space in our store buildings. Part of the space in store buildings is necessarily used for stock rooms, offices and other "non-selling" functions. Where we have separate warehouse buildings, the warehouse space is not included in the above figures.

Dividends

The dividend rate was raised to $1.40 for this latest year. The year before it was $1.20. The dividend rate for the last four years has been:

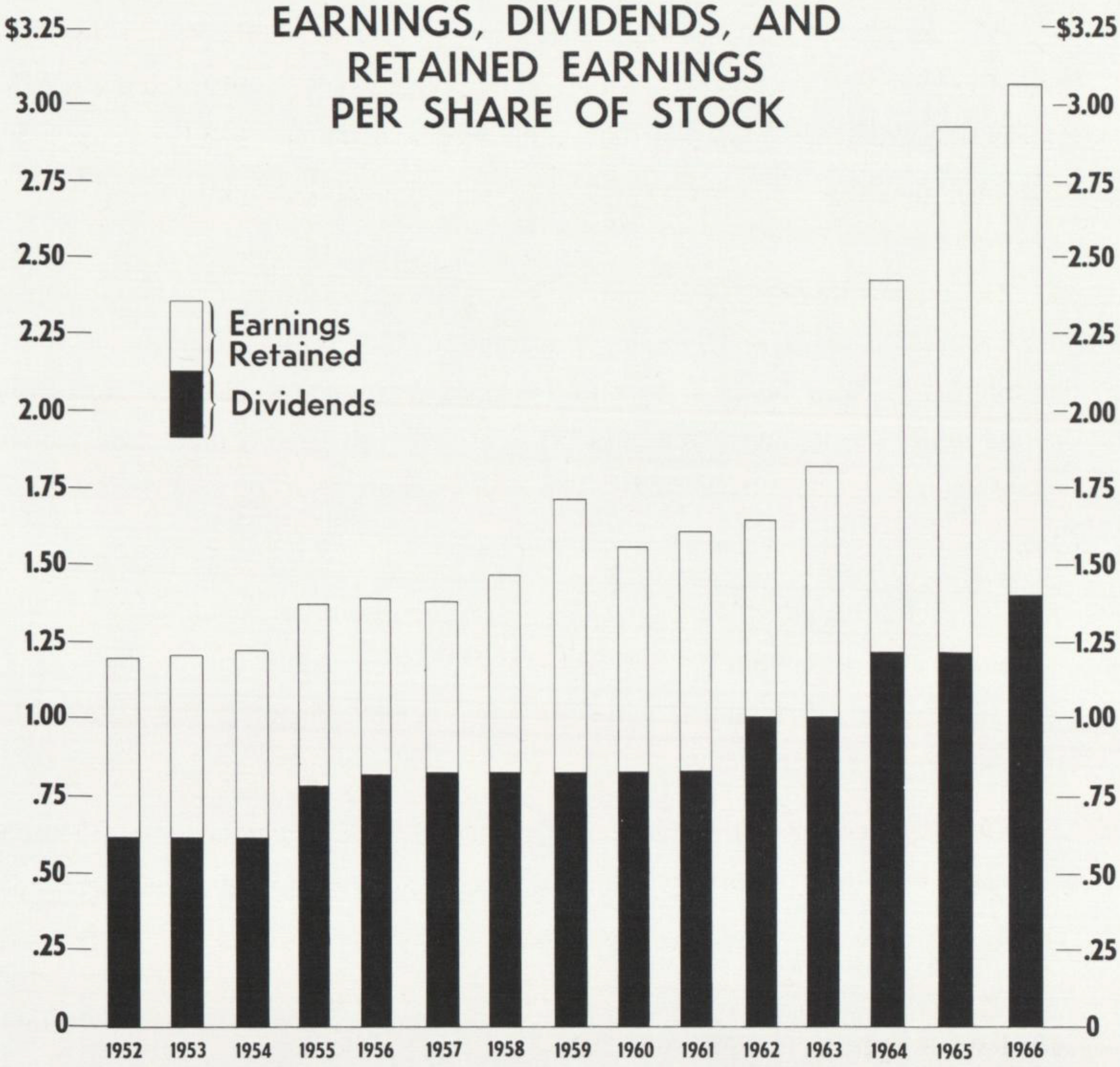
Year Ended	Dividend Rate Per Share
January 31, 1964	$ 1.00
January 31, 1965	1.20
January 31, 1966	1.20
January 31, 1967	1.40

During the year just closed, four quarterly dividend payments of 35 cents each were paid on March 15th, June 15th, September 15th and December 15th. The total dividends paid amounted to $4,126,945. This was $589,563 more than was paid out in the preceding year. Stated in terms of percentages, the dividend was stepped up by about 17% over the year before.

The dividend pay-out during the latest year was equal to about 45% of the net profit for the year. For the past ten years, the dividend pay-out has averaged about 51%—net profit for the ten years totaled $57,741,294 and the dividends paid during these ten years totaled $29,211,886. Mercantile Stores has paid dividends for the past twenty-seven years without interruption, and the dividend never has been reduced during that time.

There were 6,011 stockholders in our Company at January 31, 1967.

The chart below shows a comparison of net profit, dividends paid and retained earnings during the last fifteen years. The amounts are expressed in dollars per share.



EARNINGS, DIVIDENDS, AND RETAINED EARNINGS PER SHARE OF STOCK

Expansion During the Year Under Review

The expansion which was planned for 1966 was all completed by January 31, 1967. The principal changes which occurred during the year were:

Three new stores were opened.
Two stores were relocated to new quarters.
Two stores were substantially enlarged.
One smaller store was closed.

Three New Stores:

In March we opened our beautiful new Villa Store in a shopping center in suburban Denver, Colorado. This store of 83,000 square feet operates under the Joslin name. Joslin's began business in downtown Denver in 1873. There are now seven Joslin stores in and around Denver.

Also in March our Harding Mall store of 53,000 square feet opened for business. This store is located in a shopping center near Nashville, Tennessee. It operates under the Castner-Knott name and is identified with the downtown Castner-Knott store which began business in Nashville in 1898. There are now five Castner-Knott stores in the Nashville area.

The third store of 61,000 square feet was opened in May. This is our South Sound store located near Olympia, Washington which is about thirty miles from our long established Peoples store in Tacoma, Washington. The new store will operate under the Peoples name and be identified with the Tacoma store which began business in that city in 1888. The Peoples Store Division now operates six stores.

Two Stores Relocated to New Quarters:

Early in the year our J. B. White store in Aiken, South Carolina was relocated to new and larger quarters in a shopping center. Formerly the store operated in a downtown building.

Our Peoples Store in Yakima, Washington was also relocated in March in a brand new building of more than double the size of the older store.

Two Stores Substantially Enlarged:

A new second floor was added to our Gayfers Springdale store in suburban Mobile, Alabama. This added 57,000 square feet to the store. Our McAlpin Kenwood store in suburban Cincinnati was also enlarged so that 40,000 square feet were added to the store. These two additions were completed in the fall.

One Store Closed:

We closed the Joslin Merchants Park store in suburban Denver in January, 1967. The store of 30,000 square feet had sales in its last year of operation of about $390,000. The Merchants Park Store was opened in 1952 and turned in a nice profit for several years. Larger shopping centers were opened subsequently by our competition in that area which drained away a large part of the business of Merchants Park. Recently the store has been operating at a small loss. The lease expires in the spring of 1967 and we closed the store.

Current Number of Stores:

The stores currently in operation are listed in the back of this report (with notations of stores to open in 1967). At January 31, 1967 there were 18 divisions operating 60 stores.

Expansion During Calendar Year 1967

During the coming year we plan to open three new stores and substantially enlarge one existing store. This expansion will add about 400,000 square feet of space to the company total, equivalent to an increase in space of about 8%.

After these new stores have been in operation a few years and have earned acceptance in their respective communities, this expansion should be producing in the neighborhood of $18,000,000 to $20,000,000 of additional sales volume.

The three new stores we plan to open in 1967 are as follows:

In suburban Kansas City — a Jones Store of about 160,000 square feet.
In Lexington, Kentucky — a McAlpin Store of about 120,000 square feet.
In Bowling Green, Kentucky — a Castner-Knott Store of about 50,000 square feet.

The existing store to be substantially enlarged is our J. B. White Store in Richland Mall, Columbia, South Carolina. The additional space will be about 60,000 square feet.

* * * *

On the next two pages are pictures of various parts of some of the new and expanded stores which were completed this latest year.

ABOVE — *View of boys' department of new Villa store in Denver.*

BELOW — *The lingerie department in the enlarged Kenwood store in Cincinnati.*

Lingerie
SERVICE

ABOVE — *The millinery and wigs salon in the new Yakima, Washington store.*

BELOW — *Sportswear in the new Harding Mall store in Nashville.*

Seventy-Seven Shop
Sportswear
BLOUSES
BLOUSES

Additions and Improvements to Physical Plant

In the year just closed, the Company invested $6,886,472 in land, buildings, and fixtures. This is the largest expenditure for one year during the past decade. It is difficult to predict the timing of some of the expenditures now planned for the future, but our present estimates indicate that capital expenditures for the year we are now in—will aggregate something like $8,000,000.

The following is a summary of the expenditures for the year ended January 31, 1967:

For new stores	$1,352,652
For relocating stores to larger quarters	419,614
For enlarging and modernizing properties	3,515,287
For keeping existing properties in good condition	1,598,919
Total	$6,886,472

The largest expenditure in any one location was $1,473,304 in connection with the expansion of the Springdale Store (Mobile, Alabama). We added a floor to the building with new fixtures and refinished the fixtures previously in the store. This store has been one of our most profitable operations.

Depreciation charged to operations for the year under review was $3,485,199. This was $241,782 more than the preceding year. Quite apart from capital expenditures and depreciation, the Company spent $754,152 for repairs and maintenance, which was charged to operations.

Where the Funds Have Come From for the Expansion

The capital expenditures for the past ten years are shown in the tabulation below. The ten year total is $49,161,316. The figures by years are:

Year Ended	Capital Expenditures
January 31, 1958	$ 6,440,533
January 31, 1959	5,945,457
January 31, 1960	4,618,077
January 31, 1961	3,743,852
January 31, 1962	4,167,115
January 31, 1963	4,883,272
January 31, 1964	4,145,524
January 31, 1965	3,770,776
January 31, 1966	4,560,238
January 31, 1967	6,886,472
Ten Year Total	$49,161,316

About 89% of this total of $49,161,316 has come from retained earnings. Long term debt has increased less than a million dollars during the ten years. On three properties, sale lease-back arrangements were used. The source of the funds is summarized as follows:

From retained earnings	$43,898,469
From increase in long term debt (ten years ago long term debt was $13,892,909 and currently it is $14,572,462—increase in ten years was $679,553)	679,553
From proceeds of sale lease-back arrangement on three properties	4,583,294
	$49,161,316

Use of Electronic Data Processing

Further progress has been made in applying electronic data processing methods to our business. During this past year, customers' accounts receivable of five additional stores were converted to an automated basis. This brings the total to 22 stores in which the billing to customers has been automated. The New York office computer installation was expanded to do work for stores in the southern region of the country. Preparatory work was started on the automation of customers' accounts receivable for four more stores. Additional merchandising record keeping was automated.

During this coming year, three improved type computers will be installed to replace three computers now in use. Two of these computers will be placed geographically so that they can service stores in the surrounding areas. Merchandising and customers' accounts receivable records of additional stores will be automated after the new computers are installed.

Long Term Debt

The long term debt at January 31, 1967 amounted to $14,572,462. This is the lowest it has been in the last ten years. Nothing was added to the debt during the year. The debt was reduced during the year by $1,308,605—by regular payments on the insurance company loans ($583,000) and by payments on the mortgages ($725,605).

A sale lease-back arrangement for $1,100,000 was used in connection with the building of the additional floor on the Springdale, Mobile store. We entered into a sale lease-back on this store property when the store was built in 1960 and now we extended the arrangement with the same insurance company for financing the addition to the building.

As to the Company's commitment under leases, there are currently 79 leases which extend more than 3 years. The minimum annual rentals under these leases aggregate $2,374,001. The total rents paid during the year amounted to $2,989,734. In some leases, additional rents are paid as sales increase.

Working Capital and Short Term Bank Loans

The working capital increased during the year from $42,075,189 at the beginning of the year to $44,768,499 at the end of the year, an increase of $2,693,310. The ratio of current assets to current liabilities was 2.8 to 1 on January 31, 1967 compared with 2.6 to 1 a year ago.

During the fall season we borrowed $5,500,000 from banks under short term notes. These loans were all paid off before the end of the year. The year before the comparable short term borrowings amounted to $2,000,000, and two years back the borrowings were $4,000,000.

Return on Invested Capital

Return on invested capital dropped a little below last year's figure. Under the method we use, the figure for this year is 12.4% against 12.8% for last year.

There are several ways of computing return on investment, and there seems to be no generally accepted method. In our computation, we have related the net profit after taxes for the year—to the stockholders' equity at the end of the year. The specific figures for computing the latest year's return are net profit for the year ended January 31, 1967 ($9,074,175) and stockholders' equity at January 31, 1967 ($73,233,586).

Profit Sharing and Pension Plans

The drop in the general price level of securities which took place in 1966, cut down the value of the securities in the Profit Sharing Fund. For a typical person in the Plan, the total value of his account increased about 1% from the beginning of the year. But this included a contribution of his own money into the fund. If his own contribution is lifted out of the figures, the value of his account dropped about 3½% during the year (this drop is the net effect of the market drop in securities offset in part by dividends and interest income and the contribution by the Company). It is worth noting that the Profit Sharing Plan has been in existence thirteen years, and that during the last twelve years there has been an average investment gain of over 11% per year. To state it differently, over the last twelve years, each year there was on the average a step-up over the preceding year of over 11% (from market appreciation plus dividends and interest). The point being made here is that the over-all record of the Profit Sharing Plan has been excellent, despite the sharp drop in security prices in 1966. The market value of the funds at January 31, 1967 was as follows:

Accumulated from contributions by our people	$10,744,978
Accumulated from Company contributions	5,142,254
(Invested in 172,127 shares of Mercantile Stores stock)	
	$15,887,232

Our people contributed $1,425,647 of their own money into the Fund during the year (more than ever before—last year the figure was $1,308,277). The Company contribution (geared to profits) amounted to $694,430—a year ago the amount was $652,123. The contribution by the Company is deductible from taxable income.

As provided in the Plan, the Company contribution was allocated pro-rata among the people in the Plan in relationship to the amount each person contributed. It worked out this year that each participant's account was credited with approximately 62 cents for each dollar contributed by the individual (up to 6% of salary). A year ago the comparable figure was also 62 cents. The money contributed by the Company is invested in Mercantile Stores stock. During the year under review the Fund purchased 27,300 shares of Mercantile Stores stock. These purchases were made in the open market—with the purchases spaced out over twelve months.

There were 3,735 of our people in the Plan on February 1, 1967.

The Company also maintains a Pension Plan which has been operating for twenty-two years. There were 2,997 people in the Pension Plan at the end of the year. The funds in the Pension Plan amounted to $7,210,328 (at market value) on January 31, 1967. The Company pays the cost of the Pension Plan. Operations have been charged with $220,552 for the year under review for pension expense. A year ago the comparable charge was $100,000.

Securities in the Pension Fund were sold during the last three years at prices well above the cost of such securities when purchased by the Fund. The profits realized on such sales have resulted in keeping the cost to the Company at a lower figure for the last three years. It is not expected that there will be comparable security profits realized in 1967. Because of this, a rough estimate indicates that the Company pension expense will increase in 1967 by something like $250,000.

Current Trend

This report is being written in March. Sales in February were somewhat encouraging with an increase over a year ago of 7.3%. However, at this time of year the variations in weather throw the figures up and down to a considerable degree. If we have a blizzard in one year which closes down a store, and the next year no such storm appears, the sales variation between the two years is quite large.

Easter is very early this year. It falls on March 26th—compared with April 10th last year. For that reason, any meaningful comparison with last year will have to combine March and April together. At the time this is written, sales in March are 11% ahead of last year, but that figure is distorted by the early Easter. In reality the sales result is not that favorable.

Cash Flow

Cash flow for the year was again at a new high for the Company, at $12,684,000, equal to $4.30 per share. Last year cash flow was $11,956,000, or $4.06 per share. There has been a steady increase in the cash flow over the past ten years, as shown in the chart below:

	Net Profit	Depreciation	Deferred Income Tax	Cash Flow
January 31, 1967	$9,074,000	$3,485,000	$125,000	$12,684,000
January 31, 1966	8,600,000	3,243,000	113,000	11,956,000
January 31, 1965	7,132,000	3,413,000	27,000	10,572,000
January 31, 1964	5,370,000	3,248,000	145,000	8,763,000
January 31, 1963	4,888,000	2,933,000	262,000	8,083,000
January 31, 1962	4,818,000	2,753,000	290,000	7,861,000
January 31, 1961	4,658,000	2,559,000	352,000	7,569,000
January 31, 1960	4,985,000	2,390,000	330,000	7,705,000
January 31, 1959	4,219,000	2,706,000	—	6,925,000
January 31, 1958	3,996,000	2,388,000	—	6,384,000

Source and Disposition of Funds

Funds were produced during the year from the following sources:

Net Profit	$ 9,074,175
Depreciation	3,485,199
Sale lease-back	1,100,000
Condemnation award	175,848
Deferred income taxes	125,000
	$13,960,222

The summary below shows how these funds were used in the business:

Disposition of funds during the
year ended January 31, 1967:

22%	($ 3,095,209)	dividends declared (one of the four dividends paid in 1966 was declared in 1965)
50%	($ 6,886,472)	invested in capital assets
9%	($ 1,285,231)	used to pay off debt
19%	($ 2,693,310)	increase in working capital (Note A)
100%	($13,960,222)	

Note A

The increase in working capital:

Cash up	$1,573,972
Inventory up	1,145,864
Miscellaneous up	261,166
Current liabilities down	2,256,782
	5,237,784
Less – Receivables down	2,544,474
	$2,693,310

Progress in Fashion and Comments on Merchandising Policies

Our Company made further progress during the year in presenting fashion in our stores. An outstanding example of this is in the better dress and costume market. By better dresses we mean $40.00 and up. To separate and highlight this merchandise in our stores, we have set up what amounts to a separate shop (within the store) for this business. On the buying end, in addition to covering the New York Markets, we are going into Miami, Texas and Los Angeles for different ideas.

We have come a long way towards making our stores the centers for fashion in the communities they serve. In our larger stores we have fashion coordinators—usually a woman. She conducts fashion shows in connection with various local affairs, and in many ways gets the women of the community aware of and interested in the fashions in our stores. Show windows, interior displays, as well as newspaper and television advertising, are frequently correlated to tie a number of departments throughout the store to a particular fashion theme for a given week or month.

We have a fashion consultant in our New York buying office. We tie in with national magazine promotions of fashion such as Seventeen and Harpers Bazaar and Glamour.

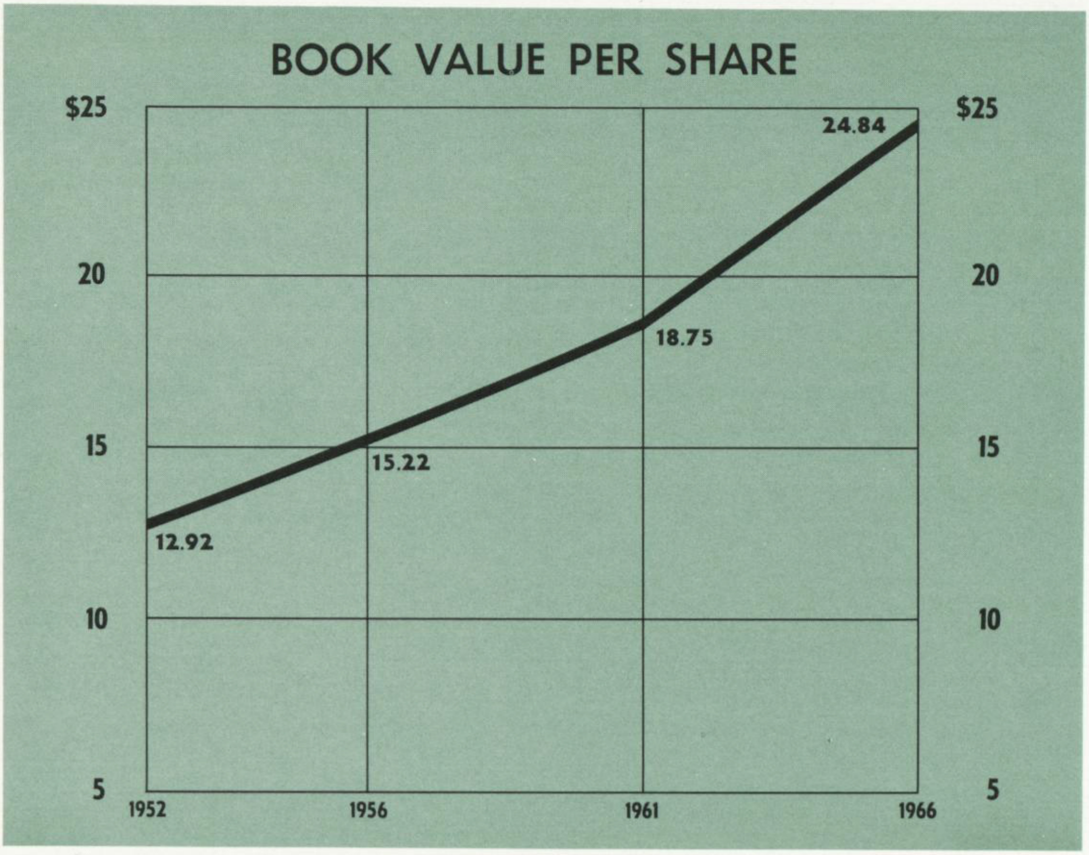
The influence of fashion is finding its way into many lines of merchandise which we once thought of as basic staples. This is conspicuously the case in many home furnishing lines such as sheets, bed-spreads, draperies, and bathroom accessories. Here again, to separate and emphasize the high fashion merchandise, we have developed separate bath shops in which magnificent color displays are presented to the customer.

Management is frequently asked the question—how much of our business is in soft goods as against hard goods. About 85% of our sales are in soft goods with 15% in hard lines. Seventeen years ago about 25% of our business was in hard goods. We are continuing to emphasize soft goods. That type of business is highly profitable for us. When we sell a customer a dress, she will be back in our store fairly soon if she likes what she bought.

Stockholders' Equity

The stockholders' equity in the Company was $73,233,586 at January 31, 1967. The total capitalization of stockholders' equity ($73,233,586) plus long term debt ($14,572,462) amounted to $87,806,048. This represents a strong capital base for our Company in which about 83% is in capital stock with only 17% in debt.

The stockholders' equity (also referred to as book value of the common stock) of $73,233,586 reflected an increase during the year of $5,978,966. The book value per share has increased every year for the past twenty-seven years (after appropriately adjusting for stock splits). The book value per share was $24.84 at January 31, 1967 (a year ago $22.82). The chart on the opposite page gives the per share figures over the last fifteen years.



Various

The management believes the customers' accounts receivable are in better than average condition. During this past year our stores have been a little more strict in the control of credit, with the result that the degree of delinquencies in the accounts is lower than a year ago.

The number of people regularly employed totals about 8,300. In peak periods the number approximates 12,000.

In February 1967, William A. Heineman was elected Treasurer of the Company. Mr. Heineman is forty-three years of age. He started with the Company at the age of 18 and has been with us for twenty-five years. He succeeds Morgan A. Casey who was formerly Vice-President and Treasurer, and who is continuing with the Company as Vice-President and Director.

At the end of the year, changes were made in the top management of two of our store divisions. William P. Fitpold stepped down as President of our Peoples Store Division in Tacoma, Washington. Mr. Fitpold has had a fine record with our Company over a span of forty-three years. He is continuing as Chairman of the Board of the Peoples Company.

Henry P. Powell succeeded Mr. Fitpold as President and executive head of the Peoples Store Division. Mr. Powell was the President of our Lazarus Store in Wilkes-Barre, Pennsylvania. He takes on more responsibility in the Peoples division which operates six stores.

Russell W. Lackie succeeded Mr. Powell as President of our Lazarus Store. Mr. Lackie formerly was the manager of our MacDougall Store in Seattle which was closed. The above changes are in accordance with our long established policy of promoting from within.

In the back of this report is a list of the presidents of our eighteen store divisions. These eighteen executives have all come up through the ranks of the Company and represent a group of men available for top management positions in the Corporation.

The financial statements, showing figures for the last two years, are given on the following pages, together with the report of our auditors, Arthur Andersen & Co., independent public accountants.

We think the most important ingredient in the success of our Company is the people who make up the Company. We thank them sincerely for their fine cooperation. We also extend our thanks to the concerns which sell us merchandise. We appreciate the way they have worked with us.

Respectfully submitted,

Harold W Jorkers

Chairman of the Board

R. Nelson Shaw

President

ARTHUR ANDERSEN & CO.
NEW YORK, N. Y.

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS,
MERCANTILE STORES COMPANY, INC.:

We have examined the consolidated balance sheet of Mercantile Stores Company, Inc. (a Delaware corporation) and subsidiary companies as of January 31, 1967, and the related statements of consolidated income, earnings retained for use in the business (earned surplus), and source and disposition of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously examined and reported on the financial statements for the preceding year.

In our opinion, the accompanying consolidated balance sheet and statements of consolidated income, earnings retained for use in the business (earned surplus), and source and disposition of funds present fairly the financial position of Mercantile Stores Company, Inc. and subsidiary companies as of January 31, 1967, and the results of their operations and the source and disposition of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Andersen + Co.

New York, N. Y.
March 31, 1967

MERCANTILE STORES COMPANY, INC.

AND SUBSIDIARY COMPANIES

STATEMENTS OF CONSOLIDATED INCOME
AND
EARNINGS RETAINED FOR USE IN THE BUSINESS (EARNED SURPLUS)

FOR THE YEARS ENDED JANUARY 31, 1967 AND 1966

CONSOLIDATED INCOME

	Fiscal Year Ended	
	January 31, 1967	January 31, 1966
Net Sales	$234,267,366	$220,610,170
Deduct:		
Cost of goods sold and expenses, exclusive of items listed below	$207,703,708	$195,598,410
Maintenance and repairs	754,152	730,689
Depreciation and amortization	3,485,199	3,243,417
Rentals paid	2,989,734	2,828,309
Interest expense	1,940,398	1,619,001
	$216,873,191	$204,019,826
Income Before Income Taxes	$ 17,394,175	$ 16,590,344
Federal income taxes	$ 7,660,000	$ 7,280,000
State and Canadian income taxes	660,000	710,000
	$ 8,320,000	$ 7,990,000
Net Income—$3.08 per share for 1967 and $2.92 for 1966	$ 9,074,175	$ 8,600,344

EARNINGS RETAINED FOR USE IN THE BUSINESS (EARNED SURPLUS)

	Fiscal Year Ended	
	January 31, 1967	January 31, 1966
Balance, beginning of year	$55,705,205	$51,673,979
Net income	9,074,175	8,600,344
	$64,779,380	$60,274,323
Dividends (see page 8)		
$1.40 per share, paid in 1967 and $1.20 per share, paid in 1966	$ 4,126,945	$ 3,537,382
$.35 per share, paid in March, 1966—declared and charged in December, 1965	(1,031,736)	1,031,736
	$ 3,095,209	$ 4,569,118
Balance, end of year	$61,684,171	$55,705,205

In the annual reports to the Securities and Exchange Commission, the cost of goods sold, central buying and occupancy expenses are $165,649,789 and $156,345,566, respectively, for the years January 31, 1967 and 1966, and selling, general and administrative expenses are $49,823,363 and $46,571,588, respectively.

MERCANTILE STORES COMPANY, INC.

AND SUBSIDIARY COMPANIES

STATEMENTS OF CONSOLIDATED SOURCE AND DISPOSITION OF FUNDS

FOR THE YEARS ENDED JANUARY 31, 1967 AND 1966

	Fiscal Year Ended January 31, 1967	Fiscal Year Ended January 31, 1966
Sources of funds:		
Net income for the year	$ 9,074,175	$ 8,600,344
Depreciation and amortization	3,485,199	3,243,417
Increase in deferred Federal income taxes	125,000	113,000
	$12,684,374	$11,956,761
Proceeds from sale leaseback	1,100,000	—
Mortgage loan borrowing	—	1,000,000
Other	175,848	—
	$13,960,222	$12,956,761
Disposition of funds:		
Dividends declared	$ 3,095,209	$ 4,569,118
Additions to property and equipment	6,886,472	4,560,238
Reduction in long-term debt	1,285,231	1,319,230
	$11,266,912	$10,448,586
Increase in working capital	$ 2,693,310	$ 2,508,175
Working capital at beginning of year	42,075,189	39,567,014
Working capital at end of year	$44,768,499	$42,075,189

MERCANTILE STO

AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS —

ASSETS

	January 31, 1967	January 31, 1966
Current Assets:		
Cash	$ 11,132,127	$ 9,558,155
Accounts receivable—		
Customers accounts—		
Regular retail accounts	$ 9,072,597	$ 8,769,411
Installment accounts not sold	987,252	1,172,128
Equity in accounts sold (the uncollected balances of which amounted to $26,363,002 and $25,812,305, respectively)	12,570,233	15,764,826
Other accounts	1,538,907	982,907
	$ 24,168,989	$ 26,689,272
Less—Reserve for doubtful accounts	2,012,946	1,988,755
	$ 22,156,043	$ 24,700,517
Merchandise inventories, priced at the lower of cost or market	$ 33,324,842	$ 32,178,978
U. S. Government and other marketable securities, at cost, approximately equal to market	$ 1,793,119	$ 1,746,778
Unexpired insurance, prepaid rent, etc.	$ 867,034	$ 652,209
Total current assets	$ 69,273,165	$ 68,836,637
Property and Fixtures, at cost:		
Land	$ 8,332,842	$ 8,007,667
Buildings and building improvements	40,169,549	39,675,441
Less—Accumulated depreciation	(17,488,115)	(16,044,775)
Store fixtures, etc.	23,520,087	20,255,248
Less—Accumulated depreciation	(9,852,814)	(9,337,457)
	$ 44,681,549	$ 42,556,124
	$113,954,714	$111,392,761

RES COMPANY, INC.

COMPANIES

JANUARY 31, 1967 AND 1966

LIABILITIES

	January 31, 1967	January 31, 1966
Current Liabilities:		
Accounts payable	$ 11,280,287	$ 11,939,491
Dividends payable.	—	1,031,736
Accrued taxes (other than Federal income), compensation, rent, etc.	7,237,576	7,447,107
Reserve for Federal income taxes	4,701,572	5,034,509
Current maturities of long-term debt	1,285,231	1,308,605
Total current liabilities	$ 24,504,666	$ 26,761,448
Long-Term Debt:		
Notes payable to an insurance company—		
3⅜% notes, due in 1967	$ —	$ 250,000
5⅛% notes, $333,000 due annually to 1977, $2,500,000 due December 1, 1978	5,835,000	6,168,000
Mortgage notes payable, due in installments over the life of each mortgage, most of which are twenty-year mortgages	8,737,462	9,439,693
	$ 14,572,462	$ 15,857,693
Deferred Federal Income Taxes	$ 1,644,000	$ 1,519,000
Lease Obligations—see comments on page 16		
Capital Stock and Surplus:		
Common stock, par value $1.83⅓ per share—Authorized and issued 2,950,998 shares	$ 5,410,163	$ 5,410,163
Less—3,180 shares held in treasury	5,830	5,830
Outstanding 2,947,818 shares	$ 5,404,333	$ 5,404,333
Capital surplus	6,145,082	6,145,082
Earnings retained for use in the business (earned surplus)—$52,575,591 restricted at January 31, 1967, as to payment of cash dividends under terms of insurance company loan agreements	61,684,171	55,705,205
	$ 73,233,586	$ 67,254,620
	$113,954,714	$111,392,761

MERCANTILE STO

AND SUBSIDIARY

TWENTY-FIVE YEAR COMPARISON OF SALES,

Fiscal Year Ended January 31	Net Sales	Profit Before Income Taxes		Income Taxes	Net Profit
		Amount	% to Sales		
1967	$234,267,366	$17,394,175	7.4%	$8,320,000	$9,074,175
1966	220,610,170	16,590,344	7.5	7,990,000	8,600,344
1965	207,260,905	14,252,235	6.9	7,120,000	7,132,235
1964	192,408,732	11,160,157	5.8	5,790,000	5,370,157
1963	183,840,305	10,297,664	5.6	5,410,000	4,887,664
1962	175,820,970	10,068,178	5.7	5,250,000	4,818,178
1961	170,247,354	9,668,412	5.7	5,010,000	4,658,412
1960	167,799,529	10,375,430	6.2	5,390,000	4,985,430
1959	157,915,790	8,709,061	5.5	4,490,000	4,219,061
1958	153,994,341	8,177,638	5.3	4,182,000	3,995,638
1957	148,773,457	8,086,964	5.4	4,060,000	4,026,964
1956	138,785,704	8,036,717	5.8	4,120,000	3,916,717
1955	130,366,021	6,970,553	5.3	3,420,000	3,550,553
1954	130,882,985	6,933,491	5.3	3,410,000	3,523,491
1953	128,603,624	7,080,850	5.5	3,620,000	3,460,850
1952	124,699,947	6,442,260	5.2	3,322,000	3,120,260
1951	125,427,006	9,397,003	7.5	4,290,000	5,107,003
1950	112,607,776	5,932,129	5.3	2,325,000	3,607,129
1949	119,091,512	8,369,725	7.0	3,243,000	5,126,725
1948	113,012,702	8,444,538	7.5	3,286,000	5,158,538
1947	103,007,184	10,800,760	10.5	4,618,000	4,682,760
1946	74,407,149	5,894,901	7.9	4,084,000	1,810,901
1945	59,668,304	6,633,941	11.1	4,854,000	1,779,941
1944	50,277,807	4,700,875	9.3	3,276,760	1,424,115
1943	41,173,113	3,340,264	8.1	2,118,645	1,221,619

NOTE A:

In the above table wherever "Per Share" figures are given, such figures are all based on the stock after the 10 for 1 split in 1946 and the 2 for 1 split in 1962 and all prior year figures have been appropriately restated.

RES COMPANY, INC.

COMPANIES

EARNINGS AND RETAINED EARNINGS

	DIVIDENDS PAID				
	On Common Stock				
Net Profit Per Share (Note A)	Per Share (Note A)	Amount	On Preferred Stock	Retained Earnings (Earned Surplus)	Book Value Per Share (Note A)
$3.08	$ 1.40	$4,126,945	——	$61,684,171	$24.84
2.92	1.20	3,537,382	——	55,705,205	22.82
2.42	1.20	3,537,382	——	51,673,979	21.45
1.82	1.00	2,947,818	——	48,079,126	20.23
1.66	1.00	2,947,818	——	45,656,787	19.41
1.63	.82½	2,431,950	——	43,716,941	18.75
1.58	.82½	2,431,950	——	41,330,713	17.94
1.69	.82½	2,423,777	——	39,104,251	17.18
1.44	.82½	2,415,029	——	36,542,598	16.35
1.37	.82½	2,411,835	——	34,738,566	15.74
1.38	.82½	2,402,442	——	31,654,763	15.22
1.35	.77½	2,248,742	——	30,030,241	14.68
1.23	.62½	1,809,999	——	28,362,266	14.12
1.22	.62½	1,809,999	——	26,621,712	13.52
1.19	.62½	1,836,849	$ 4,375	24,908,220	12.92
1.05	.50	1,470,404	17,500	22,915,344	12.32
1.72	.50	1,471,295	19,240	21,651,863	11.77
1.21	.50	1,481,220	22,040	18,035,395	10.03
1.72	.50	1,481,220	24,701	15,931,526	9.32
1.73	.50	1,481,220	25,676	12,310,722	8.10
1.57	.50	1,481,220	25,676	8,659,080	6.86
.60	.12½	370,305	25,676	5,483,216	5.79
.59	.12½	370,305	28,451	4,068,296	5.31
.47	.12½	368,930	36,176	2,687,111	4.84
.41	.12½	361,255	37,133	1,668,102	4.60

MERCANTILE STO

AND SUBSIDIARY

TEN YEAR COMPARISON OF

	January 31,			
ASSETS	*1967*	*1966*	*1965*	*1964*
Cash and Marketable Securities	$ 12,925,246	$ 11,304,933	$ 10,382,020	$ 10,139,787
Receivables, less Reserve	22,156,043	24,700,517	21,846,927	20,556,089
Merchandise Inventories	33,324,842	32,178,978	30,124,294	29,665,608
Prepaid Expenses	867,034	652,209	854,128	885,806
TOTAL CURRENT ASSETS	$ 69,273,165	$ 68,836,637	$ 63,207,369	$ 61,247,290
Fixed Assets (Net)	44,681,549	42,556,124	41,239,303	40,881,816
	$113,954,714	$111,392,761	$104,446,672	$102,129,106
LIABILITIES				
Current Liabilities	$ 24,504,666	$ 26,761,448	$ 23,640,355	$ 23,714,195
Long-Term Debt	14,572,462	15,857,693	16,176,923	17,407,370
Deferred Federal Income Taxes	1,644,000	1,519,000	1,406,000	1,379,000
Capital Stock	5,404,333	5,404,333	5,404,333	5,404,333
Surplus	67,829,253	61,850,287	57,819,061	54,224,208
	$113,954,714	$111,392,761	$104,446,672	$102,129,106
Net Working Capital	$ 44,768,499	$ 42,075,189	$ 39,567,014	$ 37,533,095

RES COMPANY, INC.

COMPANIES

CONDENSED BALANCE SHEETS

January 31,

1963	*1962*	*1961*	*1960*	*1959*	*1958*
$ 9,000,576	$ 9,832,526	$ 8,374,386	$ 7,782,702	$ 8,517,822	$ 6,910,994
27,225,565	15,778,321	15,120,028	14,741,032	12,985,902	12,491,754
28,926,550	27,070,761	26,087,816	27,429,533	24,562,675	24,511,645
723,221	914,171	1,171,057	1,057,629	1,029,165	1,238,460
$ 65,875,912	$53,595,779	$50,753,287	$51,010,896	$47,095,564	$45,152,853
39,765,753	38,020,878	36,873,849	36,837,080	36,651,716	33,562,828
$105,641,665	$91,616,657	$87,627,136	$87,847,976	$83,747,280	$78,715,681
$ 28,585,153	$18,298,178	$16,214,399	$18,257,857	$21,019,367	$17,206,139
18,616,310	17,080,123	17,850,609	18,606,453	14,828,883	15,447,820
1,234,000	972,000	682,000	330,000	—	—
5,404,333	5,404,333	5,404,333	5,404,333	5,369,591	5,363,872
51,801,869	49,862,023	47,475,795	45,249,333	42,529,439	40,697,850
$105,641,665	$91,616,657	$87,627,136	$87,847,976	$83,747,280	$78,715,681
$ 37,290,759	$35,297,601	$34,538,888	$32,753,039	$26,076,197	$27,946,714

MERCANTILE STORES COMPANY, INC.

DEPARTMENT STORE DIVISIONS

Below is a listing of the eighteen operating divisions of Mercantile Stores. Each division is under the supervision of a president and general manager (whose name is listed below). There are sixty stores currently in operation as shown in the listing.

BACON'S *Established 1845*

Louisville, Kentucky

Harold W. Johnson, President

- Downtown Louisville
- St. Matthew's
- Shively
- Jeffersonville, Ind.

CASTNER-KNOTT *Established 1898*

Nashville, Tennessee

Robert C. Hilton, President

- Downtown Nashville
- Green Hills
- Donelson
- Shelbyville
- Harding Mall
- Bowling Green, Ky. (to open in 1967)

CREWS-BEGGS *Established 1888*

Pueblo, Colorado

Richard C. Hess, President

- Downtown Pueblo

O. J. De LENDRECIES *Established 1879*

Fargo, North Dakota

Robert W. Tyler, President

- Downtown Fargo

GAYFER'S *Established 1879*

Mobile, Alabama

Fred J. Bostrom, President

- Downtown Mobile
- Springdale
- Pensacola, Fla.
- Edgewater, Miss.

GLASS BLOCK *Established 1887*

Duluth, Minnesota

Marvin Dorethy, President

- Downtown Duluth

HENNESSY'S *Established 1885*

Butte, Montana

Francis E. Canny, President

- Downtown Butte
- Helena

JONES *Established 1887*

Kansas City, Missouri

Ronald W. Ferguson, President

- Downtown Kansas City
- Blue Ridge
- Troost Ave.
- Independence
- Prairie Village, Kans.
- Pittsburg, Kans.
- Muskogee, Okla.
- Overland Park (to open in 1967)

JOSLIN'S *Established 1873*

Denver, Colorado

Donald R. Chabot, President

- Downtown Denver
- Englewood
- Lakewood
- Greeley
- Boulder
- Aurora
- Villa Italia

LAZARUS *Established 1889*

Wilkes-Barre, Pennsylvania

Russell W. Lackie, President

- Downtown Wilkes-Barre

LION *Established 1857*

Toledo, Ohio

Leon F. Winbigler, President

- Downtown Toledo
- Westgate

MC ALPIN'S *Established 1852*

Cincinnati, Ohio

William G. Stubenvoll, President

- Downtown Cincinnati
- Kenwood
- Western Hills
- Cherry Grove
- Middletown
- Lexington, Ky. (to open in 1967)

MONTGOMERY FAIR *Established 1868*

Montgomery, Alabama

Stephen E. Maxwell, President

- Suburban Montgomery
- Eastbrook
- Opelika

PEOPLES *Established 1888*

Tacoma, Washington

Henry W. Powell, President

- Downtown Tacoma
- Yakima
- Lakewood
- Port Angeles
- Wenatchee
- Olympia (Lacey)

THE RIGHT HOUSE *Established 1843*

Hamilton, Ontario, Canada

John R. Barrett, President

- Downtown Hamilton
- Brantford
- Galt
- St. Catharines

ROOT'S *Established 1856*

Terre-Haute, Indiana

Frank C. Schrohe, President

- Downtown Terre-Haute
- Sullivan
- Robinson, Ill.

J. B. WHITE *Established 1874*

Augusta, Georgia

Paul A. Martsolf, President

- Downtown Augusta
- National Hills
- Aiken, S. C.

J. B. WHITE *Established 1874*

Columbia, South Carolina

Thomas E. Hale, President

- Suburban Columbia

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Represented in the markets by
MERCANTILE STORES COMPANY, INC. (N. Y.)
(A wholly owned subsidiary company)
128 W. 31st Street, New York, N. Y.
Cable Address: Merstore